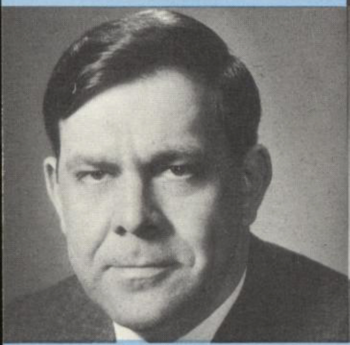
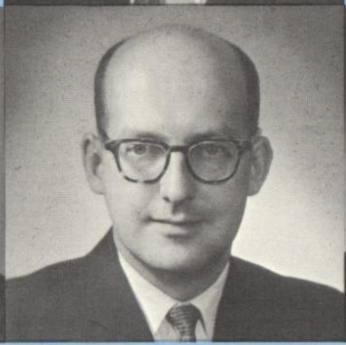
api INSTRUMENTS COMPANY

annual report 1968

David T. Morgenthaler



Harry W. Mergler



John D. Saint-Amour

Robert H. Pugsley

Board of directors

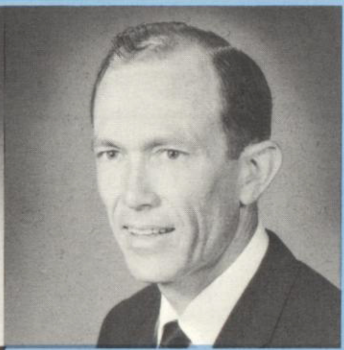
David T. Morgenthaler,
Chairman, API

Harry W. Mergler,
Director, Digital Systems Engineering Laboratory, Case Western Reserve University

John D. Saint-Amour,
President, API

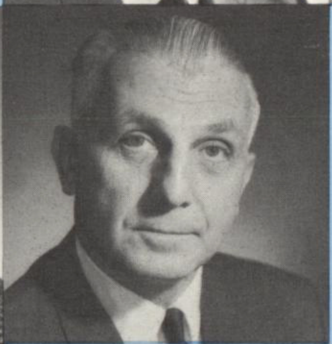
Robert H. Pugsley,
Vice President—Sales, API

George J. Crowdes, Jr.



Thomas H. Conner

Julian B. Downey



Myron W. Ulrich

John P. Isham

Officers

John D. Saint-Amour,
President

Robert H. Pugsley,
Vice President—Sales

George J. Crowdes, Jr.,
Vice President—Engineering

Thomas H. Conner,
Vice President—Finance

Julian B. Downey,
Vice President—Product Planning

Myron W. Ulrich,
Secretary

John P. Isham,
Controller

TO OUR STOCKHOLDERS, EMPLOYEES AND FRIENDS:

Profits were below expected levels in 1968 due to lower-than-planned sales, higher manufacturing costs and increased expenditures for growth.

Despite economic conditions which caused reduced purchases by several major customers, total shipments were slightly above those in 1967, reaching a new high of $9,367,294. Net income was $301,000, or 56 cents per share compared with $372,321, or 70 cents a share in 1967. The per share earnings figures for both years are computed to assume conversion of all outstanding debentures. Net income for 1968 reflects the heavier tax load imposed by the surtax.

The company's long-range interests were supported without letdown. At mid-year the directors voted to omit the third quarter dividend. The fourth quarter dividend was also passed. These actions provided the cash to sustain projects and plans already under way.

Positive results were apparent at year-end, with a much stronger sales picture in which new order bookings set a fourth quarter record.

In addition, we greatly strengthened our market effort as detailed on the next page of this report. Many new products are in the planning or development stages. New profit-oriented programs in the manufacturing area were also initiated in late 1968, and productive cost control measures have been taken.

Our labor relations remain effective, with good employee morale and no work stoppages. Pay adjustments were made to recognize increased living costs and the competitive labor market.

The fields of measurement and control, and the display of information have brilliant futures. With corporate plans and performance requirements better defined than ever before, we continue our dedication to profitable growth in these areas.

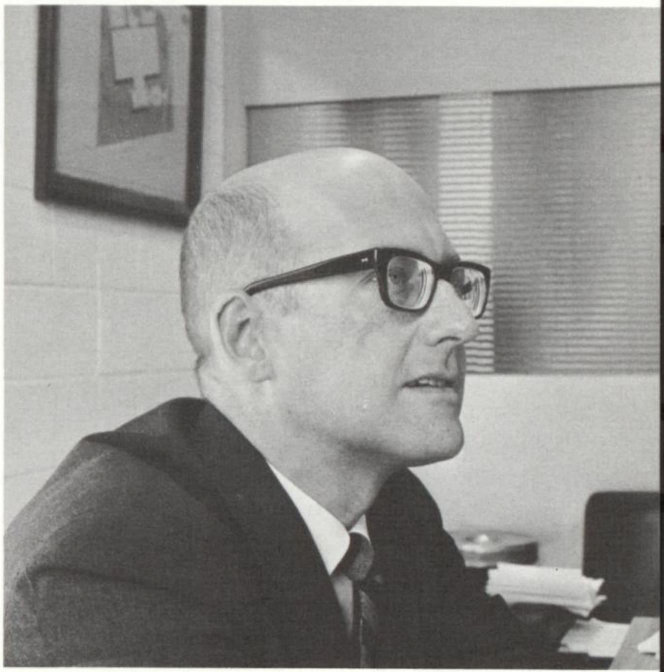
Sincerely,

John B Saint-Amour

John D. Saint-Amour
President

The record in brief

	1968	1967
Net sales	$9,367,294	$9,169,990
Federal Income taxes .	296,000	302,700
Net earnings	301,000	372,321
Earnings per share . .	.56	.70



1968

Aggressive new marketing approach

API's marketing effort has been re-organized to provide planned sales growth and preserve current markets.

Since the company's future lies in product innovation and remaining abreast of the market, the position of Vice President for Product Planning was created. J. B. Downey was selected to lead the work in determining main market targets and product requirements.

Julian B. Downey
Vice President—Product Planning

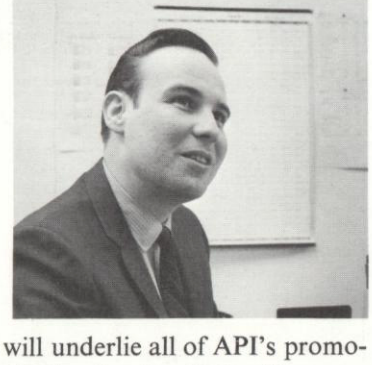
At the same time, product managers for the company's major product groupings were recruited.

L. I. Issel is Product Manager for panel meters and meter-relays. Technically up-dated versions of these products are now either coming on the market or are well along in development. One such instrument is the Ultimeter, a "building block" which combines with solid-state circuitry to provide advantages that would be much more difficult and costly to obtain with other methods.

In the temperature controller category, currently managed by Mr. Downey in addition to his other duties, the adoption of solid-state circuitry has led to great improvements. Today's instruments offer a combination of sophisticated performance, small package size and low cost that was impossible a few years ago.

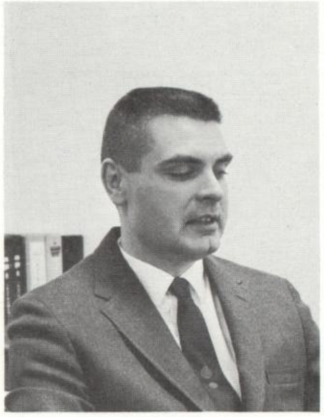
D. A. Holst is Product Manager for digital products. Here, too, integrated circuit technology is having a profound effect. In less than a year the size of API's digital panel meter has shrunk by over 50 per cent. New digital reading instruments will be introduced in 1969.

Comprehensive business plans have been developed in each product area for 1969, and strategic planning for the ensuing years is well along. This insures better concentration on products that will bring the greatest return, and establishes a timetable for future marketing efforts. It should prove a growing stimulus to sales in forthcoming years.



The product group concept will underlie all of API's promotional efforts, including a new display booth which will appear during 1969 in such major trade shows as IEEE, Wescon, ISA, the Packaging Show, the Metals and Materials Show, and others.

Another program within the marketing area is the establishment of a national service organization. R. H. Nichols has been named National Service Manager. Service facilities are planned for Chicago, Los Angeles and Philadelphia. Improved service also promises to build API sales through better customer relations.



D. A. Holst
Product Manager—Digital Products

Improved manufacturing

Late in the year M. A. Wallace was appointed Director of Manufacturing. His experience in the many facets of electronics manufacture already has had a favorable influence on operations. Costs of manufactured goods have been reduced and ambitious goals are being pursued in scrap reduction, quality improvement and other areas that will gain new customers and more profits.

L. I. Issel
Product Manager—Panel Meters, Meter-Relays

M. A. Wallace (right), Director of Manufacturing, discusses new procedures with two of API's industrial engineers.

api INSTRUMENTS COMPANY

API IN 1969

Panel meters and meter-relay controllers, the basis of API's original growth, still account for a sizable portion of sales. New products that function much like meter-relays, but have certain other distinct advantages, also have been developed and are on the market. Solid-state temperature controllers and digital products comprise major product groupings that are completely electronic and have come along only in the last year or two. Future business will demand these newer technologies along with the company's traditional products.

New products are opening new markets. In temperature control, for example, new customers have been gained in the textiles, plastics and hydrocarbon processing industries as well as the packaging field. Digital instruments are expected to find good acceptance in such burgeoning markets as medical electronics and computer control of manufacturing processes.

Among API's 5,000 present customers are most of the leading manufacturers, military installations and research establishments in the United States. Larger customer classifications include producers of medical electronics equipment, plastics machinery, packaging machinery, ovens and furnaces, semiconductor manufacturing equipment, analytical equipment, electronics measuring devices, machine tools, communications equipment, and computers.

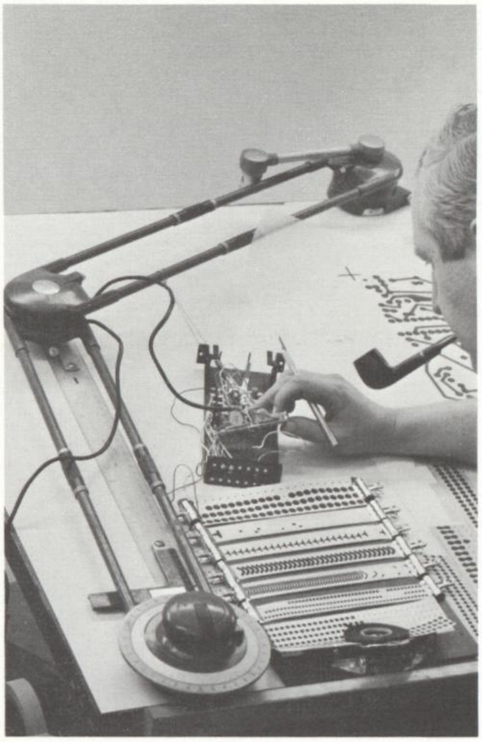
The company's two facilities in Chesterland, Ohio, total 100,000 square feet of plant space. The plant sites encompass nearly 80 acres of land. This location offers a wide choice of residential areas for API's 750 employees—the nearby Cleveland suburbs or the rural communities surrounding the plants.

The plant in Oshawa, Canada, is growing to serve industrial customers throughout that expanding economy.

API's shares, traded on the American Stock Exchange, are widely disbursed and are owned by more than 3,500 stockholders.

a

b



c

d

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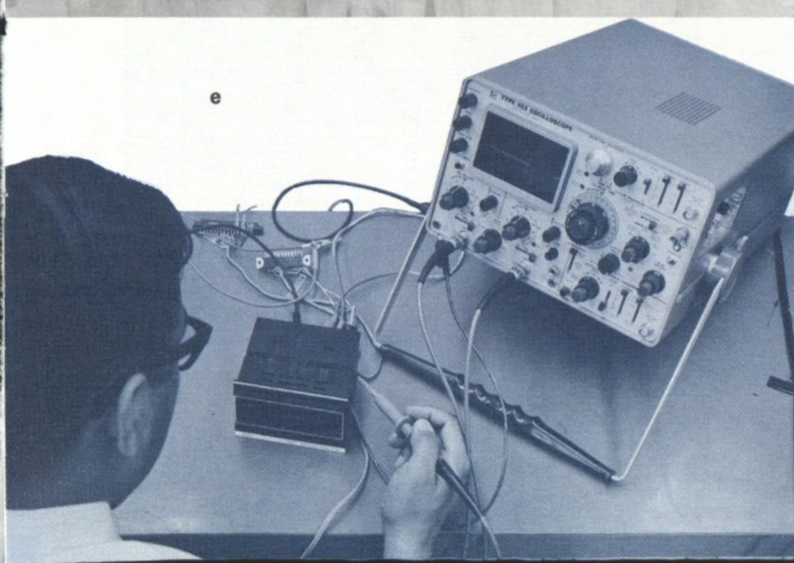
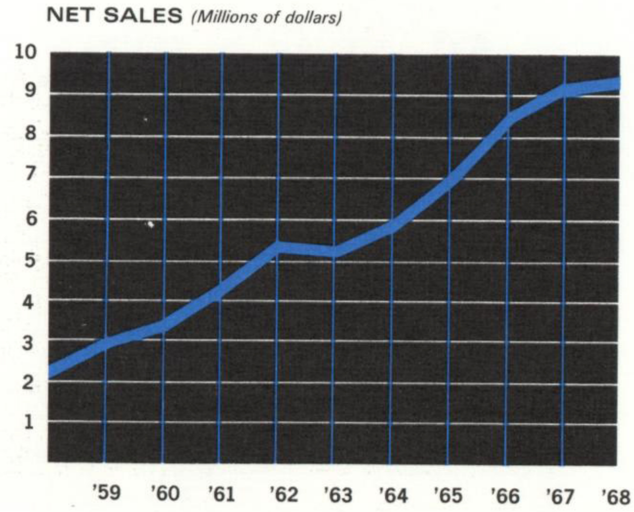


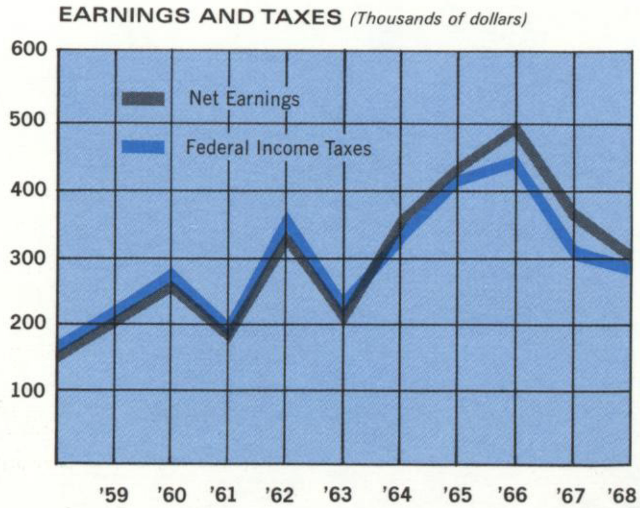
Increasing sophistication of API products calls for continuous upgrading of quality and precision (**a**). Many new products are already on the market, and others are well along in development (**b**). API encourages employees to continue formal schooling in the electronics and related fields, with up to 100% reimbursement for tuition fees (**c**). Lively competition among manufacturing departments produces the Department-of-the-Year winner, chosen for best overall performance (**d**). Digital instruments represent one of API's newest and most promising technologies (**e**).

api INSTRUMENTS COMPANY AND SUBSIDIARY

	1968
Net Sales	$9,367,294
Earnings before Federal taxes on income . .	597,000
Provision for Federal taxes on income . . .	296,000
Net earnings	301,000
Earnings per share (A)	.57
Fully diluted earnings per share (B)	.56
Cash dividends per share	.20
Additions to property, plant and equipment	132,933
Provision for depreciation	184,982
Current assets	3,802,331
Current liabilities	1,021,453
Working capital	2,780,878
Long-term debt payable	676,500
Book value per share (C)	6.65
Stockholders' equity	3,538,296

Solid-state technology assumes increasing importance in API product planning. Here integrated circuit boards are prepared for prototype controllers.





TEN-YEAR FINANCIAL SUMMARY

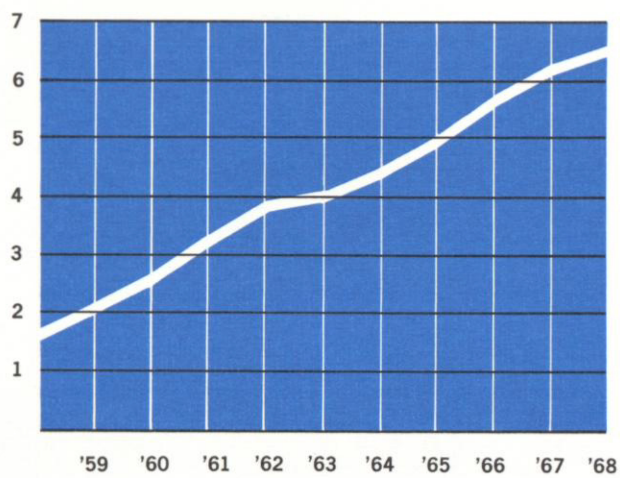
1967	1966	1965	1964	1963	1962	1961	1960	1959
$9,169,990	$8,442,131	$6,942,031	$5,812,783	$5,346,356	$5,371,164	$4,161,389	$3,400,579	$2,914,170
675,021	927,953	843,198	692,244	411,896	684,442	378,889	502,285	416,830
302,700	432,200	404,000	340,000	208,000	351,500	190,000	260,227	214,977
372,321	495,753	439,198	352,244	203,896	332,942	188,889	242,058	201,853
.73	.99	.88	.71	.41	.67	.39	.51	.44
.70	.92	.82	.67	.42	.60			
.40	.40	.35	.30	.05	.10		.10	
107,773	532,737	529,894	120,631	165,007	129,276	480,732	71,880	209,363
194,337	175,309	152,232	138,713	135,946	128,516	99,802	64,568	48,185
3,485,411	3,259,316	3,045,808	2,994,188	2,856,240	2,943,954	1,682,887	1,323,270	980,811
955,390	1,016,952	782,314	654,515	537,306	664,389	541,693	391,616	376,326
2,530,021	2,242,364	2,263,494	2,339,673	2,318,934	2,279,565	1,141,194	931,654	604,485
787,000	1,029,000	1,054,000	1,075,000	1,273,570	1,250,000	305,000	100,000	150,000
6.17	5.58	4.95	4.41	4.00	3.89	3.32	2.75	2.11
3,225,005	2,797,294	2,470,904	2,197,571	1,994,725	1,961,834	1,647,500	1,327,858	962,833

Notes: (A) Stated on the basis of average shares outstanding with the public at the beginning and end of the respective periods, adjusted for stock split (200% in 1959) and stock dividends (5% in 1960 and 4% in 1963).

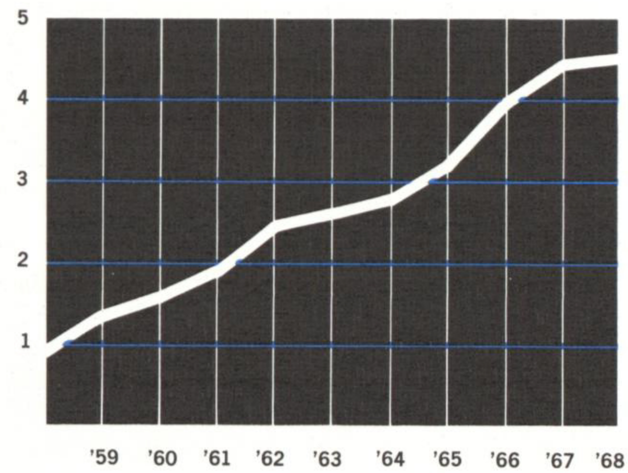
(B) Assuming conversion of all outstanding debentures issued in 1962.

(C) At close of the respective years adjusted for the stock split and stock dividends.

BOOK VALUE PER SHARE



TOTAL WAGES PAID *(Millions of dollars)*



ASSETS

	December 31, 1968	December 31, 1967
CURRENT ASSETS:		
Cash	$ 213,384	$ 212,540
Accounts receivable, less allowance for doubtful accounts of $35,000 in 1968 and $14,800 in 1967	1,607,641	1,403,449
Inventories, at the lower of cost (first-in, first-out) or market	1,925,971	1,828,796
Prepaid expenses	55,335	40,626
TOTAL CURRENT ASSETS	$3,802,331	$3,485,411
OTHER ASSETS:		
Non-current receivables	$ 32,952	$ 27,952
Cash surrender value of life insurance—net of loans	15,719	8,117
Unamortized debenture expense	18,023	26,642
	$ 66,694	$ 62,711
PROPERTY, PLANT AND EQUIPMENT—at cost (Note B):		
Land	$ 98,741	$ 98,741
Buildings and improvements	1,476,400	1,450,684
Machinery and equipment	628,819	630,489
	$2,203,960	$2,179,914
Less accumulated depreciation	836,736	760,641
	$1,367,224	$1,419,273
	$5,236,249	$4,967,395

NOTES TO FINANCIAL STATEMENTS *Year ended December 31, 1968*

A—PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of the company and its wholly-owned subsidiary, API Instruments Canada, Limited, after eliminating intercompany accounts and transactions. All accounts have been translated at the average rate of exchange for the year.

B—DEPRECIATION

The cost of new plant and equipment purchased is being depreciated over estimated useful lives using substantially the sum-of-the-years'-digits method of depreciation. The cost of used items purchased is depreciated over estimated useful lives using the straight-line method of depreciation. The principal lives used in computing depreciation are as follows:

Buildings and improvements	40 years; improvements over remaining lives of buildings
Machinery and equipment	3-10 years, principally 10 years

C—5¾% CONVERTIBLE SUBORDINATED DEBENTURES

The convertible subordinated debentures are due September 1, 1972. They are convertible into common shares at $13.46 per share (with antidilution adjustment provisions) and through August 31, 1967 were redeemable at the company's option wholly or in part at a premium of 5%. Thereafter, the premium decreases at a rate of 1% per annum. Bonds in the amount of $110,500 were converted into common stock during 1968. At December 31, 1968 there were reserved for conversion of the debentures 50,273 shares of the company's authorized but unissued common stock.

D—STOCK OPTIONS

Under the company's stock option plans, options are granted at not less than fair market value at date of grant. The options are for a period of five years and are exercisable 18 months after date of grant except that not more than 40% may be exercised within two years from date of grant, and 20% each year thereafter during the remaining option period. Cumulative provisions apply with respect to any period in which that portion of the option was not exercised.

CONSOLIDATED BALANCE SHEET

LIABILITIES AND STOCKHOLDERS' EQUITY	December 31, 1968	1967
CURRENT LIABILITIES:		
Note payable to bank	$ 100,000	$ 200,000
Accounts payable	320,353	312,645
Payroll and other taxes	136,559	125,763
Salaries, wages and commissions	226,411	173,151
Interest	14,607	15,062
Other	22,547	11,103
Federal taxes on income	200,976	117,666
TOTAL CURRENT LIABILITIES	$1,021,453	$ 955,390
5¾% CONVERTIBLE SUBORDINATED DEBENTURES (Note C)	$ 676,500	$ 787,000
STOCKHOLDERS' EQUITY:		
Common stock, par value $1 per share: Authorized 750,000 shares (Notes C and D) Issued 538,641 shares in 1968 and 529,644 shares in 1967 (including 6,934 shares held in treasury)	$ 538,641	$ 529,644
Additional paid-in capital	1,191,860	1,082,688
Retained earnings	1,846,802	1,651,680
	$3,577,303	$3,264,012
Less 6,934 shares of common stock held in treasury, at cost	39,007	39,007
	$3,538,296	$3,225,005
	$5,236,249	$4,967,395

During the year ended December 31, 1968, 800 shares of common stock were issued for $7,669 under the company's stock option plans. Changes in stock options during the year were as follows:

		Shares
Options outstanding at January 1, 1968		7,995
Options granted during 1968 at prices from $13.13 to $14.63 a share		5,100
		13,095
Deduct:		
Options exercised at prices from $9.50 to $10.19 a share	800	
Options terminated	1,600	2,400
Options outstanding at December 31, 1968, at prices ranging from $7.38 to $14.63 a share (3,811 shares exercisable)		10,695
Shares available for future grants		16,030

E—PENSION PLAN

The company's contributory retirement pension trust covers all employees who have at least three years of service and who desire to make the required contribution toward the acquisition of life insurance contracts providing retirement benefits. The company pays an amount equal to twice the amount contributed by the employee. Total pension expense was $65,441 in 1968 and $56,576 in 1967. No past service liability exists under the plan.

CONSOLIDATED STATEMENT OF EARNINGS

	Year Ended December 31, 1968	1967
NET SALES	$9,367,294	$9,169,990
COSTS AND EXPENSES:		
Cost of products sold, exclusive of depreciation, amortization and taxes	$6,664,902	$6,421,801
Selling, administrative and general expenses	1,527,668	1,471,861
Depreciation	184,982	194,337
Taxes, other than federal taxes on income	291,522	283,925
Provision for uncollectible receivables	37,000	38,375
Interest expense (including amortization of debenture expense)	64,220	84,670
	$8,770,294	$8,494,969
EARNINGS BEFORE FEDERAL TAXES ON INCOME	$ 597,000	$ 675,021
PROVISION FOR FEDERAL TAXES ON INCOME Less Investment Credit of $3,840 and $12,083	296,000	302,700
NET EARNINGS	$ 301,000	$ 372,321
Net Earnings Per Share of Common Stock:		
Primary (based on average common shares outstanding, 527,208 shares in 1968 and 512,474 shares in 1967)	$.57	$.73
Fully diluted (assuming conversion of all outstanding debentures, giving 581,567 shares in 1968 and 579,924 shares in 1967)	$.56	$.70

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	1968	1967
BALANCE, beginning of the year	$1,651,680	$1,484,170
Net earnings for the year	301,000	372,321
	$1,952,680	$1,856,491
Cash dividends—$.20 a share in 1968 and $.40 a share in 1967	105,878	204,811
BALANCE, end of the year	$1,846,802	$1,651,680

CONSOLIDATED STATEMENT OF ADDITIONAL PAID-IN CAPITAL

	1968	1967
BALANCE, beginning of the year	$1,082,688	$ 842,958
Excess of proceeds received over par value of common shares (800 shares in 1968 and 2,513 shares in 1967) sold upon the exercise of stock options (Note D)	6,869	15,688
Excess of face value of 5¾% convertible subordinated debentures over par value of common shares issued upon conversion (8,179 shares in 1968 and 17,958 shares in 1967) (Note C)	102,303	224,042
BALANCE, end of the year	$1,191,860	$1,082,688

See notes to financial statements.

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

	Year ended December 31, 1968	1967
FUNDS PROVIDED:		
Operations:		
Net earnings for the year	$ 301,000	$ 372,321
Charges to net earnings requiring no expenditure of funds:		
Depreciation	184,982	194,337
Amortization of debenture expense	8,619	15,657
Write down in non-current receivable	—	7,000
FROM OPERATIONS	$ 494,601	$ 589,315
Proceeds from stock options exercised	7,669	18,201
	$ 502,270	$ 607,516
FUNDS APPLIED:		
Cash dividends paid	$ 105,878	$ 204,811
Net additions to property, plant and equipment	132,933	107,773
Increase in non-current receivables	5,000	—
Increase in cash surrender value of life insurance	7,602	7,275
	$ 251,413	$ 319,859
INCREASE IN WORKING CAPITAL	$ 250,857	$ 287,657
SUMMARY OF WORKING CAPITAL:		
Current assets at end of the year	$3,802,331	$3,485,411
Less current liabilities at end of the year	1,021,453	955,390
WORKING CAPITAL AT END OF THE YEAR	$2,780,878	$2,530,021
Working capital at beginning of the year	2,530,021	2,242,364
INCREASE IN WORKING CAPITAL	$ 250,857	$ 287,657

See notes to financial statements.

ACCOUNTANTS' REPORT

The Stockholders and Board of Directors,
API Instruments Company, Chesterland, Ohio

We have examined the accompanying consolidated balance sheet of API Instruments Company and subsidiary as of December 31, 1968, and the related statements of earnings, retained earnings, additional paid-in capital, and source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of API Instruments Company and subsidiary at December 31, 1968, and the consolidated results of their operations, and the source and application of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche, Ross, Bailey + Smart

Cleveland, Ohio
March 8, 1969

Certified Public Accountants.

api INSTRUMENTS COMPANY | Chesterland, Ohio 44026